Two Theories of Monopoly and Competition: Implications and Applications

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This paper addresses the claim that monopolies arise naturally out of the free market. I show by comparing and contrasting two theories of monopoly—economic and political monopoly—that this is not true. This paper also demonstrates that the two theories of monopoly have their separate roots in two opposite theories of competition: perfect competition and competition as rivalry. I show that only one of these theories of competition accurately describes the nature of competition in an economy. In addition, I show how these different theories of competition and monopoly are derived from diametrically opposed political philosophies: collectivism and individualism. I illustrate how perfect competition and economic monopoly have undermined economists' understanding of the actual nature of both competition and monopoly. As a part of my investigation of these very different theories of competition and monopoly, I apply them to show how, depending on which theories one accepts, one will come to very different conclusions about when monopoly power does or does not exist.

INTRODUCTION

It is often claimed that a free market leads to large firms gaining monopoly power and being able to restrict the output of the goods they produce to arbitrarily raise their prices (see Gwartney, et al., 2000, pp. 126-127 for a typical statement of this point). This alleged monopoly power is said to lead to greater economic inefficiency, a lower productive capability, and a lower average standard of living. Hence, it is said the government must step in to restore competition, such as through the antitrust laws. In this paper, I show that this claim is based on an invalid view of competition and monopoly. I show that the free market leads to the most intense competition that is possible in any industry and that deviating from a free market, with some form of government interference in the name of allegedly making competition more intense, actually decreases the intensity of competition that exists in the economy and thus decreases the level of economic efficiency, the productive capability, and the standard of living. This paper is based on chapter two of my book *Markets Don't Fail!* (Simpson, 2005, pp. 31-57).

ECONOMIC VERSUS POLITICAL MONOPOLY

There are two concepts of monopoly that exist and they do not provide an equally good understanding of monopoly. The concept accepted by most economists today is the one that is deficient, and it is the acceptance of this invalid concept of monopoly that leads them to (incorrectly) believe that monopolies arise out of the free market. The concept of monopoly accepted by most economists today is known as the economic concept of monopoly. This concept says a monopoly exists when there is only one supplier of a good, with no close substitutes, in a given geographic region (see Arnold, 2001, p. 528 for a typical exposition of this concept). The concept that provides a sound understanding of monopoly is known as the political concept of monopoly. This concept says that monopolies arise from the government's initiation of physical force to reserve a market or a portion of a market to one or more sellers. My discussion of the political and economic concepts of monopoly is based on the discussion of these concepts in the book *Capitalism: A Treatise on Economics* (Reisman, 1996, pp. 376-377 and 389-392).

The economic concept of monopoly focuses on the number and size of firms in an industry. It says the smaller the number of firms in an industry, and the larger those firms are, the more monopoly power that exists in that industry. It says monopoly power can arise naturally out of the market simply by firms becoming the only firm in an industry. Based on this concept, the greater the market share a firm has the greater its monopoly power. The political concept focuses on the restriction of competition by the government and says monopoly power can be held by many small producers against just one or a few large producers, or can be held by one large producer against other, smaller producers. The political concept says as long as a firm is being protected from competition by the government—no matter what its size—then that firm has monopoly power.

As examples, Microsoft, Wal-Mart, and the United States Postal Service (USPS) are considered monopolies based on the economic concept due to their large size and market share in their respective markets. However, of the three, only the USPS is a monopoly based on the political concept. Only it has achieved dominance in its market through protection from competition by the government. In fact, not only are Microsoft and Wal-Mart not monopolies based on the political concept, they are actually victims of monopolies. Wal-Mart has force initiated against it by local governments (in favor of smaller retailers) in the form of ordinances that put a maximum limit on the square footage of retail stores in certain locations. These ordinances are designed to keep Wal-Mart out by making the size smaller than what Wal-Mart considers necessary to make it worth it for Wal-Mart to open a store in an area. This is a case of a larger number of smaller firms (i.e., local grocery and other retail stores) gaining and using monopoly power to protect themselves from competition from a larger and more efficient rival.

Microsoft has had force initiated against it through the antitrust laws (in favor of such companies as Sun Microsystems and Netscape [the latter now being a part of America Online]). These laws initiate force and thus prevent voluntary trade by, for instance, limiting the market share of some firms in particular industries and preventing some firms from merging (see Simpson, 2005, pp. 67-72 for more on how the antitrust laws create political monopolies). Microsoft is a case of firms using monopoly power to protect themselves from a competitor that produces better products and is more effective at selling those products.

The main problem with the economic concept of monopoly is that it groups together firms that have achieved their dominant positions through voluntary trade (i.e., by outdoing their rivals *through* competition), such as Wal-Mart and Microsoft, with firms or organizations that have achieved their dominant or sole-supplier positions through the government's initiation of physical force (i.e., by the government protecting them *from* competition), such as the USPS. It does so based on the characteristic that these two types of firms or organizations both have a large market share in their industry. By doing this, it ignores how these firms came to acquire their dominant positions.

These two situations should not be grouped together because the ways in which the companies have achieved their dominant positions are diametrically opposed to each other. The case based on voluntary trade is a part of competition and the one based on the government's use of force is an act of restricting competition. That is, the former case is a part of the rivalrous act of firms building a product and trying to get individuals to voluntarily buy it. This is what competition in an economic system is all about. Anything that results from this process does not create monopoly power because it is part of the *competitive* process. The latter case is a situation in which one or more firms are prevented from building and selling a product. This is why it represents a restriction of competition and therefore creates monopoly power.

For example, Wal-Mart has achieved its dominant position in the retail industry by being relentlessly competitive. It does everything possible to keep its costs and prices low, such as using an extremely efficient inventory control system and requiring its vendors to keep their costs as low as possible and pass the savings on to Wal-Mart. If a company cannot match Wal-Mart's costs and prices—if it cannot handle the competition—it will be difficult for it to survive. Of course, many have not, as Wal-Mart has driven many companies out of business.

The same cannot be said of the Post Office. It has become the sole deliverer of first-class mail because it is legally protected (by the Constitution) from others competing in the delivery of such mail (some have tried and have been stopped, see Friedman, 1990, p. 288 for an example). The government not only forcibly prevents others from delivering first-class mail, it forces taxpayers to subsidize the Post Office. If taxpayers were not forced to subsidize the Post Office and the delivery of first-class mail was performed under free competition, there are a number of companies that would probably enter the field (such as Federal Express and United Parcel Service) and drive the Post Office out of business (unless it became more efficient and provided higher quality service). The case of Wal-Mart and the Post Office are complete opposites because the former involves competition and voluntary trade while the latter involves protection from competition and the prevention of voluntary trade.

Because monopoly is a concept used to identify situations where competition is absent or restricted, one cannot use it to identify situations that are the result of competition, such as when firms achieve dominant positions by producing and selling better products. By grouping together situations that are the result of competition with situations that are the result of restrictions of competition, the economic concept obliterates a crucial difference and leads people to inappropriately identify when monopolies do or do not exist; that is, when competition is actually restricted or not.

Having a large market share is not essential to whether a firm has monopoly power or not. However, because the economic concept focuses on this characteristic—as if it is the essential characteristic of monopoly—it leads to arbitrary and contradictory conclusions as to whether firms are monopolies or not. For instance, the economic concept leads to claims that no firm is a monopoly and all firms are monopolies, depending on how broadly or narrowly one defines a good. Further, it leads to claims that a firm both is and is not a monopoly.

For example, if one defines a good by brand names (such as Chevrolet or Ford), every firm is a monopoly because each firm is the only seller of its brand-name product. However, if one broadens his definition of a good and, continuing with the same example, considers the good "automobile" or, expanding it further to, "mode of transportation" then neither Chevrolet nor Ford is a monopoly and no other firm is a monopoly either. This is the case because all producers of automobiles compete with each other, as well as with other modes of transportation, such as trains, buses, and airplanes. This example can be applied to any industry (see Reisman, 1996, p. 390 for a similar example).

Depending on how one defines a good, what one person says is a monopoly and what another says is a monopoly could be quite different. One could say that no business is a monopoly and all businesses are monopolies, or that a firm both is and is not a monopoly. Because of this, the economic concept is meaningless. It is a subjective concept because it can be used in an arbitrary manner to say whether a monopoly exists or not.

One might object to my claim here by saying that two brands of automobiles with similar types of vehicles are really close substitutes and therefore not, in fact, monopolies based on the economic concept. However, if one puts forward this argument, one misses the point I am making. It is true that those who embrace the economic concept of monopoly believe that the criteria of whether products are close substitutes should be used as the basis to determine whether a single supplier of a good, and therefore a monopoly, exists. But I am not arguing about what basis we should use to determine whether a producer is a single supplier of a good. I am saying that we should not use the "single supplier" criteria at all as the basis for determining whether competition is restricted and thus whether a monopoly exists. Whether a firm is a single supplier of a good is not essential to whether competition exists or not. That is why the economic concept of monopoly leads to arbitrary and contradictory claims with regard to who is a monopoly.

The arbitrary nature of the economic concept of monopoly has been illustrated eloquently in the Microsoft antitrust case. Here, different economists have given contradictory answers to the question of whether Microsoft is a monopolist. They do so based on their different opinions concerning what the relevant market is for Microsoft's products and therefore how large of a market share Microsoft has (Maurice and Thomas, 2002, pp. 482-483). The arbitrary nature was also seen in the court decisions made in the Microsoft case. Here, U.S. District Court Judge Thomas Penfield Jackson ruled Microsoft was a monopoly and ordered the breakup of the company, while a Federal Appeals Court reversed the breakup order. Contradictory conclusions inevitably result when a concept is not defined based on the essential characteristics of the concept (see Rand, 1990, pp. 40-54 and Peikoff, 1991, pp. 96-105 for a discussion on the proper method of defining concepts).

There is no confusion, contradictions, or inappropriate classifications based on the political concept. Any producer or producers that are protected by the government from competition are monopolists, whether through government issued licenses, tariffs, quotas, exclusive franchises, subsidies, or government owned enterprises. This is a valid concept because it is not subjective and arbitrary who is a monopolist; it is objective. One cannot claim that a firm both is and is not a monopoly based on the political concept. A firm either has monopoly power or it does not. Further, one does not lump firms that have achieved their dominant position through voluntary trade, such as Wal-Mart and Microsoft, with organizations that have achieved their dominant position through the initiation of physical force, such as the Post Office.

Based on a proper understanding of what a monopoly is, one can say that Microsoft and Wal-Mart do not have any monopoly power because they are not protected from competition in any way by the government. More significantly, one can say that *monopolies do not arise naturally out of the free market*. *The only time a monopoly exists is when the government interferes with the free market* using the initiation of physical force to protect some firm or firms from competition. Below I will show that it is only when a firm possesses monopoly power based on the political concept that the standard negative effects associated with monopoly arise. Only then will a firm be able to arbitrarily restrict its output to raise its price. Only then will it produce in a much more inefficient manner. This is so because only then is competition actually restricted.

PERFECT COMPETITION

"Economic monopoly" stems from the theory of competition that most economists accept and is known as "perfect competition." The five standard characteristics of a "perfectly competitive" industry are insignificant barriers to entry and exit, a large number of small producers, homogenous products, "perfect information," and price-taking firms (see Arnold, 2001, p. 501 for a typical presentation of these characteristics). It helps in understanding any concept to concretize what the concept means or implies in reality. By doing this, one can see whether a concept makes sense based on the facts or whether a concept is absurd and meaningless. By concretizing "perfect competition" I will show that the latter applies to it. My critique of perfect competition is based on criticisms presented in *Individualism and Economic Order* (Hayek, 1948, pp. 92-106) and *Capitalism: A Treatise on Economics* (Reisman, 1996, pp. 430-432).

First, consider the idea that all products must be the same to have perfect competition. What does this imply? It implies that there is no competition with respect to differentiation in quality and style. This means that if perfect competition is to exist, firms cannot try to make their product different from or better than their rivals' products. Therefore, this concept of "competition" actually excludes one major aspect of competition. Furthermore, there would be no variety in the types of goods that exist. As one can easily observe in the marketplace, competition has the exact opposite effect.

Second, what about the idea that an industry must have a large number of small firms in order to be considered perfectly competitive? This excludes competition by companies to drive their costs down and gain a competitive edge over their rivals by achieving economies of scale. This is probably one of the most intense aspects of competition in the marketplace. If every industry was composed of a large number of small firms, costs in many industries would be higher, and this would lead to a lower productive capability and standard of living. Again, this is the exact opposite result that is achieved by competition.

Third, what about the idea that an industry must have insignificant barriers to entry and exit to be perfectly competitive? This ignores a crucial distinction between two types of barriers to entry that one must consider when assessing whether competition exists: natural and government imposed barriers. Natural barriers, such as high capital requirements, brand loyalty, or knowledge about how to produce a good, are a part of competition and voluntary trade. For example, a firm gains customer loyalty by producing a product customers like so much that they will not easily switch to a different brand.

Government imposed barriers impede competition and voluntary trade and are achieved through the initiation of physical force. They are achieved by the government forcibly preventing some firms from competing (such as through granting government franchises, as in the case of electric or cable television utilities), making it harder for some to compete (such as through tariffs, quotas, and licenses), or by providing an artificial advantage to some companies (through subsidies). These types of barriers restrict competition.

By ignoring the fundamental distinction between these two types of barriers to entry, perfect competition lumps these two fundamentally different things together and says when *any* barriers exist competition is lessened. This means it lumps together industries such as the New York City taxicab industry, which has substantial government barriers, and the computer hardware manufacturing business, which has high capital requirements, and says both of these industries lack competition because of these barriers. However, this could not be farther from the truth. The computer business is extremely competitive *because* of the high capital requirements, and thus low costs, that have been achieved in that industry. Achieving these low costs has been a part of the competitive process in this industry. Whereas competition is restricted in the New York City taxicab business because of the extremely expensive government required medallion one must have to be in the business legally (costing about $400,000 to $500,000 for each medallion!), which forcibly keeps many potential competitors out of the business.

Fourth, what about the idea that perfect information must exist for an industry to be perfectly competitive? This is blatantly absurd. Perfect information implies that humans must be omniscient in order for competition to exist. However, part of competition is competition concerning information and knowledge. Competition to gain knowledge about what methods of production to use, competition to gain knowledge about customers (such as through focus group studies), and competition among firms to disseminate information about themselves (such as through advertising) are all important aspects of competition. By assuming that we must have perfect information to have an allegedly perfect form of competition, again, a major component of competition is excluded.

Fifth, what about the idea that perfectly competitive firms are price takers? This characteristic ignores the fact that many firms *set* their prices based on costs of production they can achieve. Firms compete intensely by continuously driving their costs down, setting a lower price, and thus gaining a competitive advantage over their rivals. Hence, in requiring firms to be price takers, perfect competition excludes another aspect of competition.

Perfect competition, as economists often admit, does not exist anywhere in reality. Sometimes it is claimed that agricultural industries, such as wheat farming, come closest to being perfectly competitive because the products are close to being identical and the farmers take whatever price they can get for their products in the commodity markets. However, even these industries fail to meet the standard in many ways. First, it takes a large amount of capital to get into the agricultural business (think of all the land and sophisticated machinery one must possess). Second, perfect information most certainly does not, and cannot, exist in farming or any other industry (think of all the knowledge about agriculture one must have to be a successful farmer). Third, because of the high capital and knowledge requirements needed to get into the farming business, significant barriers to enter the business exist.

As F. A. Hayek recognized, perfect competition is not a form of competition at all; it actually means the *absence* of all competition (Hayek, 1948, pp. 92 and 96). Under perfect competition, there is no competition to differentiate one's product, no competition to gain economies of scale and drive one's costs down, and no competition to gain or disseminate information. It is not a valid concept because it has nothing to do with the actual nature of competition and exists no where in reality.

In addition, nothing is improved by the use of the terms "oligopoly" and "monopolistic competition." These are terms that are based on the invalid concepts of economic monopoly and perfect competition and are used to identify varying degrees of alleged monopoly power. Monopolistic competition is used by contemporary economists to describe situations in which firms have small differences in their products (such as in the grocery business or with regard to gasoline stations) and thus begin to violate the characteristics of perfect competition. The concept says monopoly power begins to exist when small differences arise. This means it is thoroughly rooted in the notion that the "sole-supplier" criteria should be used in determining whether monopoly power exists. It merely identifies firms that are not yet sole suppliers, but have some of the characteristics that begin to move them in that direction.

Oligopoly is a term used by contemporary economists to identify industries that have a few firms in the industry that have most of the market share in the industry (such as the automobile industry or the steel industry). The concept is based largely on the number and size of firms in industries and identifies industries in which the degree of alleged monopoly power is somewhere between monopolistic competition and a "pure" economic monopoly. Since it is based on the economic monopoly/perfect competition view of competition and monopoly, it must also be discarded. Neither "oligopoly" nor "monopolistic competition" provide us with any better understanding of the nature of competition and monopoly or the competitive nature of the industries they categorize because they are both based on invalid views of competition and monopoly.

A good concept of competition is one based on rivalry. This says that "to compete" one must try and outdo one's competitors in production and voluntary trade. It means a firm tries to differentiate its product, drive its costs down and set a lower price, advertise, and drive its competitors out of business by getting customers to voluntarily switch to its product. This provides one with a good understanding of how competition actually takes place in an economic system.

How does this relate to the discussion on monopoly? The economic concept of monopoly is a corollary of perfect competition. That is, if one accepts that competition is most intense in an industry that has a large number of small producers each producing identical products, then monopoly exists when there is only one producer of a good with no close substitutes. In order to reject this invalid concept of monopoly, one must also reject perfect competition. Likewise, to fully embrace a proper understanding of monopoly—political monopoly—one must have a proper understanding of competition. That is, one must understand the competition that takes place in an economic system is a rivalrous process that occurs between producers who attempt to get people to voluntarily purchase their products. The opposite of this is when production and voluntary trade is restricted through the initiation of physical force. This is identified by the political concept of monopoly.

THE PHILOSOPHICAL BASIS OF PERFECT COMPETITION AND ECONOMIC MONOPOLY

The philosophical basis for why many economists accept the validity of perfect competition and economic monopoly is provided by egalitarianism and collectivism, ideas that many economists embrace. Egalitarianism is the belief that people should be the same in all respects. We should all have the same amount of income, the same opportunities, abilities, etc. For example, if I possess some greater ability than others, I should some how "give up" some of my ability and "give it" to others. Maybe, the egalitarians might say, I should hold back so as not to make others look worse and feel bad about their lack of talent. Or maybe I should spend less time developing my own talent and more time helping less talented individuals develop their skills. Others should do the same in the areas where they have superior ability. The alleged ideal is a society in which everyone is equally talented and no one is superior to any other person at anything.

The type of world that would exist if everyone was exactly the same is the bizarre world of perfect competition. For instance, under perfect competition, no one would have an advantage in the information he possesses because producers would all have perfect information. Likewise, everyone would produce identical products, no one would have a cost advantage because firms would all be the same small size, and all businesses would receive the same price that prevails in the market. Perfect competition is an egalitarian ideal. And if this is the competitive ideal then being different (especially superior) in any way would create some element of (economic) monopoly. Differences between competitors stand in opposition to egalitarianism. Therefore, if one takes egalitarianism seriously, he will end up believing it is beneficial to have all competitors exactly the same, and consider it harmful when one competitor has an advantage, in any way, over the rest.

One might argue regarding my point about egalitarianism that most (and maybe even all) advocates of egalitarianism do not advocate everyone being exactly the same, but rather believe that we should merely eliminate some of the inequality that currently exists in the world. This might be true but does not deny my point that egalitarianism provides the philosophical basis for perfect competition. Here I am not concerned whether economists embrace egalitarianism consistently or not. I am concerned with the nature of the idea. Whether egalitarianism is the basis for perfect competition does not depend on whether economists embrace it consistently. What matters is the nature of egalitarianism and perfect competition. Based on their characteristics, it is easy to see that egalitarianism provides the philosophical basis for perfect competition.

The problem with egalitarianism is that it is not a proper standard by which to judge anything. Economically, implementing egalitarian policies would lead to a lower average standard of living (Reisman, 1996, pp. 145-146) by sacrificing the productive to the unproductive through such schemes as the progressive income tax and the inheritance tax. Morally, such a standard is an abomination because it stands in opposition to the requirements of human life. It prevents the individual from being the beneficiary of his own actions by morally requiring the individual to be a rightless servant to the needs of others (Rand, 1971, pp. 152-186). This is a thoroughly collectivist idea because it says individuals must live for others. If people are to survive and flourish, they must be free to pursue their rational self-interests; they must not be sacrificed to the needs and whims of others.

Moreover, perfect competition is an attempt to wipe aside the individual's role in competition. This is another way in which perfect competition is a collectivist idea. It says, in essence, that producers should mindlessly stamp out the same products and serve customers (Ridpath, 1999, pp. 178-179). It says individual differences should play no role in competition and, in fact, any differences are to be condemned as alleged monopoly power. What this theory forgets is that *competition occurs between individuals.*

Just as economic monopoly and perfect competition are based on egalitarianism and collectivism, political monopoly and competition as rivalry are based on individualism. These latter fully recognize the role of the individual in competition by recognizing that competition takes place between individuals. They recognize that individuals possess different skills and financial resources and that these differences are a part of the competitive process. They recognize that each individual has a right to his own life and should live it to further his own well being and happiness, which includes outdoing others in the rivalrous process of economic competition.

Ultimately, to reject perfect competition and economic monopoly, one must reject egalitarianism and collectivism. Likewise, to embrace a proper theory of competition and monopoly, competition as rivalry and political monopoly, one must embrace an individualist political philosophy.

BARRIERS TO ENTRY

To gain a better understanding of competition and monopoly, it will help to go through some specific examples to see what actually does and does not constitute a monopoly. To do this, I will discuss a few specific types of barriers to entry and assess them based on the political concept of monopoly.

Patents, Copyrights, and Trademarks

It must be stressed that monopoly power exists only when the government *initiates* physical force to reserve a market or a portion of a market for one or more sellers. Based on this, patents, copyrights, and trademarks do not create monopolies, even though they are often thought to do so based on the economic concept of monopoly simply because they create an entry barrier. Patents, copyrights, and trademarks protect intellectual property from being used by others without the owner's consent. Just as the government must use *retaliatory* force to protect, say, a grocer's inventory (i.e., physical property) from being stolen by others, it must do the same with intellectual property (such as protecting the use of an invention with a patent, the use of an author's book with a copyright, and the use of brand names and logos with trademarks). Protecting patented devices, copyrighted material, and trademarks is similar to protecting any other property that a person owns.

There are some differences between protecting intellectual property and physical property that I will not discuss here. For instance, there are time limits on the protection of some intellectual property (such as patents and copyrights), while there are none on physical property. But the essential point that protecting intellectual property is similar to protecting physical property remains valid. For a discussion on why differences in protecting the two types of property exist, see the book *Capitalism: The Unknown Ideal* (Rand, 1967, pp. 130-134).

The protection of patents, copyrights, and trademarks helps to increase efficiency, quality, and the supply of goods by making it possible for those who create wealth or develop a good reputation to profit from it. Patents provide the ability and incentive to develop new inventions or make improvements on old ones. Copyrights provide the ability and incentive to produce higher quality written matter. Trademarks provide a strong incentive to maintain quality by making it possible for a company to gain from the reputation it has built. These are the exact opposite effects of a monopoly.

Monopolies decrease economic efficiency, quality, and the supply of goods because they violate individual rights by protecting producers from competition. Economic competition can only take place within the context of voluntary trade, and the latter can only exist when people are protected from the initiation of physical force, i.e., when individual rights are protected

(Simpson, 2005, pp. 7-9). This is what patents, copyrights, and trademarks do; they are a part of what makes competition possible.

Based on a proper understanding of monopoly, *not* protecting patents, copyrights, and trademarks would constitute a monopoly. It would be the establishment of a monopoly of the dull and incompetent by forcibly depriving the intelligent and competent of the benefit of their intelligence and competence. Such a situation would constitute an act of the initiation of force by the dull and incompetent, sanctioned by the government, to gain access to things they could have never created and thus to obtain a portion of a market they could have never gained access to on their own through voluntary trade. (Reisman, 1996, pp. 388-389)

Economies of Scale

Gaining efficiencies through economies of scale does not constitute a monopoly, although it is often believed to do so based on the economic concept of monopoly (Reisman, 1996, p. 376). Economies of scale are achieved through intense competition to drive costs down through the accumulation of capital, the acquisition of knowledge, and the efficiencies in production and improvements in quality that can be gained based on this foundation. Potential entrants to an industry, if they want to compete successfully, must be able to achieve the low costs of production that those currently in the industry have already achieved.

If the government provided new firms with the capital and knowledge to compete (this latter, perhaps, by requiring existing companies to provide their trade secrets to new entrants), this would constitute a monopoly of those who have not earned the capital and knowledge against those who have. The government would be initiating force against existing companies to force them to provide newcomers with their trade secrets, or against taxpayers to provide newcomers with funds to purchase capital goods. In either case, this would lead to a lower productive capability. It would either take away the ability and incentive for firms to acquire more knowledge (since it is likely firms would be forced to provide that knowledge to newcomers), or it would take away the financial incentive to be efficient and produce products that consumers demand (since newcomers could obtain funds from taxpayers instead of having to raise funds from investors through voluntary means).

Sole Control of a Resource

Gaining sole control of a resource does not constitute a monopoly if it is achieved through voluntary trade. Remember, a monopoly does not depend on having only one producer of a good; it depends on whether competition is forcibly restricted. If someone had the foresight to buy up the total supply of a resource, this is an achievement that is based on the ability of the person buying the resource. Such an acquisition is based on voluntary trade and does not constitute a restriction of competition (in fact, it is a part of competition). Further, recognizing and developing uses for a particular resource take great ability. Such activities help to increase the productive capability of the economic system. This can be seen in the case of the aluminum industry where, up through the mid-twentieth century, Alcoa controlled virtually the entire supply of land that contained Bauxite ore, a chemical from which aluminum is made. Without Alcoa's efforts to discover better ways to produce and use aluminum, the development of the aluminum industry, and industries that are heavily dependent on aluminum (such as the aircraft industry), would probably have developed in a much slower fashion.

Taking away resources from someone, if acquired through voluntary trade, would violate individual rights and constitute a monopoly. It would be a monopoly of those who did not have the means and ability to acquire the resources through voluntary trade against those who did. This would decrease economic efficiency and the productive capability of the economic system because firms would have less ability and incentive to acquire and develop uses for resources in the future.

Network Effects

Network effects are said to lead to monopoly power because they create switching costs and allegedly lead to “lock-in effects” and “path dependency.” For instance, it is often said that people can get locked into an inferior standard or product just because it was the first one to gain a significant market share. Therefore, it is claimed that it may be impossible even for superior goods to unseat an inferior “network good.” This has been alleged to occur with such goods as the typewriter, the VCR, computer operating systems, and computer software, among others.

Even if lock-in and path dependency existed, they would not create a monopoly as long as the widely-accepted standard was established based on voluntary trade. However, Stan Liebowitz and Stephen Margolis have shown that lock-in and path dependency do not exist. For instance, with respect to the typewriter it is claimed that the allegedly inferior QWERTY keyboard (named for the letters on the top left-hand side of the keyboard) has maintained its popularity simply because it was the first one to be widely used and that an allegedly superior late comer, the DSK (or Dvorak) keyboard, has not been widely used because of the early success of the QWERTY keyboard. The DSK was said to be superior because the arrangement of the keys allegedly made it possible to type faster. The claim by supporters of the “network effect” monopoly argument is that no one learns how to use the DSK keyboard because DSK keyboards are hard to find and DSK keyboards are hard to find because no one learns how to use them. However, a detailed study of the history of the keyboard shows (1) that the QWERTY keyboard faced intense competition during the late-nineteenth century, when the battle occurred to establish the standard, and it emerged from that competition as one of the better keyboards, and (2) that the DSK keyboard offers no clear advantage over the QWERTY keyboard. The lock-in/path dependency tales in other industries fall victim to a similar fate. (Liebowitz and Margolis, 1999, pp. 11-14, 19-46, 120-129, and 163-200)

With regard to switching costs, although they do exist in some industries, they are simply a part of the competitive process with which firms must deal. They are facts of economic reality that are not to be bewailed simply because they are not in agreement with one’s arbitrary desires. One cannot wish an aspect of the nature of reality (including the nature of competition) out of existence. One can only accept it. The people who bemoan the nature of competition and wish for an alternative (whether “perfect competition” or the absence of switching costs) are guilty of attempting to rewrite reality. They think that reality is deficient simply because it is not as they wish it to be. They think it is perfectly valid to pine for the elimination of something that cannot be erased, i.e., to wish for an “alternative” reality (see Rand, 1982, p. 30 and Peikoff, 1991, pp. 26-30 for more on the fallacy of rewriting reality).

If the government was to interfere to help a firm overcome switching costs, this would create monopoly power, even if the firm it was helping had a better product and would eventually dominate the market without the government’s help. The government might initiate physical force against taxpayers to force them to subsidize the firm with the new product or the government might somehow restrict the competitive ability of existing firms. While the existence of switching costs as such does not lead to inefficiency and the acceptance of inferior standards, government interference to help firms overcome switching costs does. For example, if firms are subsidized, it causes the firms to be more inefficient because they can rely on funds expropriated from taxpayers to cover their costs. Hence, they will less likely be concerned with keeping their costs down. In addition, help from the government for companies with inferior products will help those companies to achieve a greater market share than they otherwise would be able to. Also, when the government helps firms with superior products, this creates a monopoly by helping those firms to achieve a dominant position in a quicker fashion than they otherwise would be able to through the competitive process.

CONCLUSION

As one can see, monopolies are not created by the free market. They are created only by government interference into the free market; they are created when the government gives some firm(s) special privileges over others through the initiation of physical force. A free market economy is intensely competitive and is typically more so the larger the firms in an industry are and the fewer the number of firms that exist in an industry.

There are numerous practical implications for the ideas discussed in this paper. They require a radical re-assessment of the competitive nature of the U.S. economy. They require a radical re-interpretation of the antitrust laws as well. Typically, those laws are seen as anti-monopoly. However, these laws are based on the invalid concepts of perfect competition and economic monopoly. When seen in the light of the valid concepts of competition as rivalry and political monopoly, one comes to a radically different conclusion regarding the antitrust laws. One sees them as undermining competition and voluntary trade and thus creating monopoly. To make the economy more competitive, these laws must be abolished. The implications for the ideas discussed in this paper with regard to the antitrust laws are discussed in detail in chapter 3 of *Markets Don't Fail!* (Simpson, 2005, pp. 63-72).

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